

NATIONAL PCS CONSORTIUM, INC.

24 WOODBINE ROAD  
FLORHAM PARK, NJ 07932  
(201) 377-6269 (201) 377-2143 (FAX)

EX PARTE OR LATE FILED

DOCKET FILE COPY ORIGINAL

May 30, 1994

William Caton  
Secretary, Acting  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

FILED  
JUL 1 1994  
FCC MAIL ROOM

Dear Mr. Caton:

Enclosed are the Original and four (4) copies of two of our Ex Parte Filings regarding 90-314.

Very truly yours,



Terrence P. McGarty  
President, NPC, Inc.  
President, The Telmarc Group, Inc.  
Chairman, Telmarc Telecommunications, Inc.

No. of Copies rec'd  
List ABCDE

029

EX PARTE OR LATE FILED

90-314

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Comments on	)	
Docket 90-314	)	May 30, 1994
Regarding PCS, Competition, and	)	
Set Asides for Designated Entities	)	
Comments From	)	
National PCS Consortium, Inc.	)	

JUN 1 1994  
FCC MAIL ROOM

**EX PARTE**

**SET ASIDE FOR DESIGNATED ENTITIES AND ISSUES OF  
ANTICOMPETITIVENESS**

The National PCS Consortium, Inc., the "Commentor", represents itself and PCS experimental operator, Telmarc Telecommunications, Telmarc Group, and Telmarc Mountaineer Telecommunications. The Commentor has itself, or through one of its affiliates, filed comments directly on these issues or others over the period of this docket. The comments contained in the Ex Parte filing, as suggested by the Commission, relate to the issues, raised by and discussed by the Commission in the Panel Discussions of April 11-12, 1994, specifically the dealing with non-current monopoly operator in the local PCS markets. The Commentor again raises the issue that the Regional Bell Operating Companies, and GTE, (henceforth called the "existing entities") have a special position as the existing dominant monopolist operator in all the significant markets in the United States, holding both a wireline monopoly as well as a dominant position in a duopolistic wireless band, currently termed the "cellular" wireless band. The Commentor argues, and will attempt to present the brief on said argument, that the allowance of these entities as bidders with any other bidders will disenfranchise any and all of the other bidders and will result in a continuation of the monopoly power of these players in what is now a potentially fully competitive market. Specifically these players have dominant market power and control over the means of production and that by tying in their access fees, monopoly rents, and monopoly cash flows they can eliminate the chance of any new entrant being successful.

***1.0 PCS provides, at a minimum, the ability of any new entrant to deliver toll grade quality voice services in a seamless interoperable nation network. This service or product offering is the provision, at a minimum, of voice grade service. It is the same as the service offered by the current Local Exchange Carriers, LEC, and is the same that could be potentially offered by the existing cellular carrier.<sup>1</sup>***

This states that PCS is nothing more than "plain old telephone service". It clearly has the potential of providing telephone service at a more competitive price than a wire based service. It is totally cross elastic with a wire based service. Namely, the consumer cannot differentiate with either offering other than possibly through the extra mobility afforded by PCS. In essence, PCS makes wire and wireless telephone service a simple commodity, indistinguishable to the consumer solely on the basis of the technology. The distinguishing feature will most likely be the price and only the price, as it is with all commodities. PCS allows for the commodification of local exchange service.<sup>2</sup>

***1.1 PCS, cellular, and wire based local exchange services are indistinguishable from the perspective of the buyer. Therefore, PCS can and should compete with the LEC and the wire based service.***

If the intent is to create a competitive alternative to the local loop and, simultaneously, to expand the telecommunications services offered, then PCS offers a significant alternative means to do so. Experimental efforts to date have indicated that the consumer does not necessarily view PCS as a separate service offering. If priced competitively and positioned competitively, the consumer views PCS as a displaceable alternate to the wire based telephone.<sup>3</sup>

***1.2 The "Market" for PCS is the same as the "Market" for the LEC based services of today. The "Market" for cellular is the same as the PCS "Market".***

There is no material or other observable or measurable difference in the offering of PCS and wire based service and the markets for both are the same. The consumer may choose between the two.<sup>4</sup>

---

<sup>1</sup> In McGarty, 1990 [1], the demonstration is made that the networks as evolved with CS can be constructed in a fully open and distributed fashion. It was in this paper that the concept of commodification was first presented.

<sup>2</sup> Telmarc Telecommunications NPRM Comments to the FCC, November 8, 1992.

<sup>3</sup> McGarty, 1992 [2]. This paper details the trials in PCS showing the consumer commodification efforts. Also see Telmarc Quarterly Report, July 1, 1993, which details extensive market research in this area.

<sup>4</sup> The Court, in United States v. E.I. duPont de Nemours & Co. (Cellophane), 351 U.S. 377 (1956), introduced the concept of cross elasticity to determine the market. Although there is no true market measure at this time, extensive market research indicates that there is anticipated to be great cross elasticity as defined by the Court in the aforementioned.

***2.0 PCS enables the commodification of voice services and establish the possibility for any new entrant to sell the same service to the consumer, with the consumer purchasing the commoditized service solely on the basis of price.***

***2.1 PCS allows for the total cross elasticity of supply to the consumer of telephone service.***

It is argued that the service offered by the dominant entity or the RBOC LEC is fully displaceable by PCS and that as such competes with the LEC in its primary market.<sup>5</sup>

***3.0 New entrants into the PCS business do not face economies of scale in capital plant that have been faced by prior entrants, thus justifying the prior monopoly position of the LEC. PCS entrants, by means of outsourcing, can also obtain all support and sales services at marginal prices and thus each Local Service Operator, LSO, does not have a scale economy in the operations and sales sides of the business. Thus there are no economies of scale in the PCS business and the justification for any monopoly player is no longer valid on economic principles.***

It has been shown that new entrants have the ability to establish capital plant in such a way as to have marginal capital and average capital be almost the same at very small market penetrations, less than 0.5%. Thus there are de minimis scale economies in capital plant. In addition there may be scale in support and operating services, but by outsourcing, and using the economy scope of a third party, such as an ISSC or EDS or CSC (as did NEXTEL), an entrant may purchase such service at the margin. Thus any new entrant may see entry costs all at the margin.<sup>6</sup> This implies that there is no natural monopoly. In fact this implies that competition may be quite significant.

***4.0 Competition in the PCS market, for voice amongst other services, will be commoditized and the consumer choice will be made on the basis of price, if such is possible. Choice on price for the consumer is Pareto optimal.***

With the aforementioned characteristics, the product or service offering will be based upon price. New entrants will compete primarily on price, and their prices will reflect their costs. The consumer welfare is always maximized by maximizing choice while also minimizing price. Price could be so minimized in this market by having full competition and clearing the market on a fully competitive price basis.<sup>7</sup>

---

<sup>5</sup> In the decision of *Telex v. IBM*, the Tenth Circuit Court ruled that IBM had monopolized the market on the basis of the sale of peripheral products that were commodizable in the terms in which we use herein.

<sup>6</sup> McGarty, 1994 [1], and Telmarc Quarterly Report to the FCC, April 1, 1994.

<sup>7</sup> McGarty, 1993 [2] discusses the competitive aspects of fully competitive markets versus monopoly and duopoly markets. It is shown that in the current monopoly market the price is twice what it could be for telephone service in a competitive market. This fact has been borne out in the IEC market where long distance rates have been haled in the last ten years.

***5.0 The existing entities control many of the means to production, including but not limited to the access fees.***

There are four sets of players in the PCS market characterized by their market power. The first are the existing entities, namely the RBOCs and GTE, who each and together have significant market power through their existing monopoly presence. The second are the IECs and other existing communications entities who provide telecommunications services but have no control over local access.<sup>8</sup> Third are the non telco players such as the CATV and utility companies. Fourth are the designated entities such as small businesses, women and minority companies. Of these four classes, only the existing entities control access, a key means of production for the delivery of the basic telecommunications services.

***5.1 The existing entities have control of almost 100% of the market in wire based distribution of the telephone service, with some diminution due to local bypass entities. The existing entities have control over almost 75% of the current wireless market as a means of distribution of telephone services.***

There is some mis-perception that the cellular carriers differ in some way with PCS. The cellular carriers, having 25 MHz of spectrum each, half of which was given to the RBOCs free of any cost, and half won in lotteries, and subsequently purchase, half of that being by RBOCs, is just bandwidth. The RBOCs can and are doing with 800 MHz bandwidth what can and may be done with the 1.8 GHz bandwidth. Bandwidth is fungible. Pac Tel had stated in 1990 that they could provide service to all of Los Angeles using CDMA and the existing 25 MHz 800 MHz spectrum.<sup>9</sup>

***5.2 Telephone services, as a commoditized entity, do not differ in any way if delivered by a wire or wireless means. The consumer perceives the service as the same in either case. Thus there is complete cross elasticity in a commoditized market.***

***5.3 The delivery of telephone service, when differentiated by wire based or wireless, is the same service but sold through a different sales and marketing channel. There is no basic product differentiation between a wire based service and a properly delivered wireless service. The only difference is price as reflected throughout the distribution channel.***

---

<sup>8</sup> This would include AT&T, MCI, Sprint, as well as the new entities such as Columbia PCS, a new PCS entrant backed in part by Fidelity investments, a current participant in SMR and other telecommunications services. The designated entity companies are true small businesses, women or minority owned businesses as specified by the Commission, unlike the aforementioned players.

<sup>9</sup> Statement of Craig Farrill, Vice President of Pac Tel, at CTIA in January 1991, talking on their choice of CDMA, as related by Farrill to the author in June of 1991, and as supported as having been heard by John Stupka, President, Southwestern Bell Cellular to the author in September of 1991.

The essence of what makes wireless and wire based services different is merely the sales or distribution channel. The sales channel is a different company, although owned by the same holding company. Pac Tel was the only RBOC to publicly recognize this and separate the two entities. The current differential between the two services is price, and this is driven by capital and operation inefficiencies in the analog technology. These will disappear in the digital technologies.

***5.4 The current wireless market is controlled by Duopoly Players, one being an existing entity, called the B side wireline carrier, who was granted at no cost the 25 MHz of spectrum, and another A side player, called the non-wireline player. More than 50% of the current wireline players are existing entities, namely RBOCs or GTE. All of these entities may deliver a telephone service comparable to that on the wire based side. Some of them currently do.***

***5.5 No non-wireline entity, other than the non RBOC or non-GTE entities, has debated the issue of access fees in order to offer a price competitive product to the consumer so as to compete with the wire based service.***

***6.0 The value of the bid in the auction is dependent on the net present value of the property being auctioned. That value is a function of the revenue, expenses, capital, auction fee, access fee, and cost of capital as perceived by the bidder. If all bidders face the same revenue stream, capital requirement, and expense stream, the bid values will reflect access fee, auction fee, and cost of capital differences. This will advantage those with low costs of capital and control over access. If a bidder is more efficient by having lower capital costs and lower expenses, this efficiency may be masked in the bid process by bidders with monopoly rents to protect, lower averaged auction costs, and assured zero access fees.***

The existing entities have the capability to average their access fees across the new means of distribution.

***6.1 The existing entities may be in a position to bid several times greater per PoP in almost all markets to ensure survival of the monopoly rent. This would result in the reduction of short term profits in expectation that the losses would be recouped from the continual realization of monopoly profits.<sup>10</sup>***

It has been proposed to give the designated entities a 25% discount on bidding. This does not even make up for the higher cost of capital that such entity may face. Calculations showing a 90% discount have been shown to be more realistic to compete, but are unacceptable from a policy perspective. Fronting is also possible, as has been proposed and demonstrated by Columbia PCS backed by Fidelity Investment and others yet to be announced. Fronting may also mean fronting by an RBOC or designated entity. This would be a clear sham.

---

<sup>10</sup> Such an action, if actually exercised is predation.

**6.2 The existing entity may have the ability to use their existing monopoly powers to ensure preservation of their monopolies. This would create a barrier to entry to any new entrants.**

**7.0 The existing entities face the lowest cost of capital of any bidders and in addition have a monopoly rent value that increases their valuation per PoP. In addition these bidders, as a group, have control over some of the means of production, including but not limited to access fees. Thus these players, per force of their existing monopoly franchise, have a higher value per PoP, assured by the government franchises, and thus can outbid any player in a free and open auction.**

The existing entities can economically tender are higher bid based upon rational financial grounds.

**7.1 Access Fees are a key means of production. They are currently viewed as a means of compensating the RBOC for use of its facilities and payment for certain yet to be defined network externalities.<sup>11</sup>**

**7.2 Access fees include the costs of interconnect plus other costs and services that go beyond interconnect. Access fees are not unbundled costs for interconnect.<sup>12</sup>**

The RBOCs have bundled many costs into access. For example, the IEC may face a \$0.05 per minute access whereas the cellular carrier may face a \$0.11 per minute for comparable service. Recently, NYNEX proposed changing access in New England from \$0.07 to \$0.035 per minute. These fees load such items as Bellcore and internal Science and Technology costs, which may for the most part have no relation to access. In fact, these R&D costs relate to new products and services and not to unbundled access.<sup>13</sup>

---

<sup>11</sup> McGarty, 1994 [1] discusses the three views of access, namely Externality View, Bilateral View and Competitive View. Simply Externality means pay the RBOC unilaterally since they bring you the customer, bilateral means both parties pay but at a rate to be negotiated, and competitive means that access fees are abandoned for comparable forms of interconnect.

<sup>12</sup> As shown in McGarty, 1993 [1] through [4], and 1994 [1], access fees tie together elements such as interconnect, R&D, sales and services, and other elements of the telephone companies services, and have been indicated as such by the LECs in filing to various Public Service Commissions. Interconnect is what is sought, and unbundled from any and all other elements. It can be argued that this "tied" offering, which provides ability for interstate traffic and commerce, which is not expressly conveyed to the access buyer, which can be separated into a multiplicity of products as evidenced by the actions of Ameritech, and over which the LEC has significant economic power to control both availability and price, and which ostensibly has not clear business justification, implies that access fees are potentially tying claim, as per *Jefferson Parish Hospital No. 2 v. Hyde*, 466 U.S. 2 (1984).

<sup>13</sup> The Commentor was Head of Research for NYNEX and as such was responsible for the management and direction of such efforts and there can be viewed as a subject matter expert in this area.

***8.0 Competition in local exchange services will be permitted only if the existing entities do not receive a preferential bidding position and lock out other competitors from the bid process.***

The other entities, including the collection of designated entities, AT&T, MCI, Sprint, rural telephone companies, and other non-existing entities (the "other entities") face a bid profile that makes a rational financial investment in the bidding process at a lower level. For example, even AT&T, which has a lower cost of capital than any of the other entities, still must overcome the access fee barrier as well as the monopoly rent barrier.

***9.0 Competition from other entities, specifically the designated entities, who may perforce of their lower operating costs and lower cost for infrastructure capital, may be able to offer a more competitive service than any other entity if they were to obtain a license.***

The designated entities have entrepreneurial capabilities that will permit lower costs and a competitive market. It has been argued by many such groups that represent these entities that a set aside is the only way for them to compete. Notwithstanding this, a set aside may be appropriate for the designated entities but a set aside for the RBOCs only, delimited to at most one band, is essential for there to be any long term competition.

***10.0 The auction process which mixes existing entities with other entities will not be an efficient allocation of resources since it will drive out the efficient providers of service through a one time action of the bid which ensures the preservation of the monopoly amongst the existing entities.***

***11.0 The Budget Reconciliation Act of 1993 and the FCC Report and Order on PCS of September 22, 1993 create a de facto competitive market for local exchange service. The Administrative relief to monopolies under §7 of Clayton<sup>14</sup> afforded through the aegis of the Federal Communications Commission was based upon the belief that as a monopoly, one so permitted by the scale and scope in the provision of services, and so permitted under the Act of 1934, is now under question, if, under the above two mentioned items, the provision of local exchange service is no longer a monopoly perforce of scale and scope, and that new entrants are permitted to offer service.***

Although there is intent to create competition, and although the RBOCs are protected from antitrust violations by the 1934 Act, the state of telecommunications after a free and open auction may be drastically different. If the existing entities are delimited to one of the bands and no more, then new entrants are perforce of that delimitation allowed to enter, provide that an strong anti-fronting statute is also enforced. It is clearly to the RBOCs advantage to delay, to obfuscate, to improve the position of their existing channels, and to perform other acts that ensures them greater share of the market prior to the entry of any

---

<sup>14</sup> Clayton § 7; "Nothing contained in this section shall apply to transactions duly consummated pursuant to authority given by the....Federal Communications Commission,..."



competition.<sup>15</sup> This is the same set of issues that were prevalent in the 1970s during the early stages of the AT&T breakup.<sup>16</sup>

***12.0 The ability of the dominant carriers, namely the RBOCs and GTE, to bid in any and all PCS bands creates a chilling effect to any other bidder, be they IECs, Designated Entities, or other carriers or no carriers.***

***13.0 The Commission has established an effective precedent in the establishment of cellular licenses of permitting the dominant entities access to one and only one band. It is recommended that such be the case for PCS. It is argued that without this being the case, the dominant entities will have full and complete monopoly power to obtain ongoing monopoly control over a competitive market and through predatory pricing and tying arrangements in access can create an anticompetitive environment for any and all other entrants. In fact it is argued that the mere presence of the dominant entities in the auction will have a chilling effect on any and all other competitors.***

The issuance of cellular license by the Commission has established a viable and workable precedent. Namely, set aside a band for RBOC and GTE auctions. The let all other bands be for open bidding. This may beg the question of Designated entity set asides but this is not a market competitiveness question in and of itself

***14.0 The Commentor finally argues that in the event that auctions assign bands to RBOCs in some dominant fashion, dominance being defined within the confines of Sherman or Clayton, that the dominant entities may, as a group, exercise monopoly control and effect actions to continue the exclusion of any new competitor in the local exchange market. The Commentor also argues that such bidding options, as that of all the existing entities bidding in all bands, may have a chilling effect on other bidders, and such effect may reduce significantly the opportunities for competition. The Commentor argues that such actions may be viewed, after the fact of the auctions, as potential violations of the antitrust statutes***

***The above set of arguments have been based upon detailed studies performed by Telmarc over the past three years.<sup>17</sup>***

---

<sup>15</sup> Recent pricing of cellular at such rates as \$29.95 per month for unlimited local service in Boston by Southwestern Bell is an example of pricing to obtain market share. Recent estimates put Southwest in Boston at almost 400,000 subscribers of a market of 4 million, almost 10% market share. It will be very difficult for any new entrant to get that share away from them. In addition, although Telmarc has been arguing for access fee elimination in Massachusetts, neither the NYNEX Mobile company nor Southwestern have raised that issue. In a duopoly market, such a fee is common to both players and is not a barrier. In a fully competitive market, this would change.

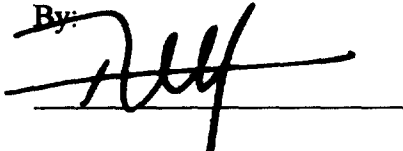
<sup>16</sup> Temin, P., Fall of the Bell System, Cambridge, 1987, p. 129. Here the author recounts Van Deerling suggestions of abandoning FCC control and oversight and reintroducing the antitrust laws which control competitive markets. It can be argued that the same effect is taking place here.

<sup>17</sup> The following references have been used in the text. They have been referenced by year and by the number in which they appeared in that year:

Respectfully submitted,

National PCS Consortium, Inc.  
May 30, 1994

By:



Terrence P. McGarty  
President  
National PCS Consortium, Inc.  
24 Woodbine Rd  
Florham Park, NJ 07932  
201-377-6269

Dated: May 30, 1994

---

1990 [1], McGarty, T.P., *Alternative Networking Architectures; Pricing, Policy and Competition, Information Infrastructures for the 1990s*, Harvard University, J.F. Kennedy School of Government, - Nov. 1990.

1993 [1], McGarty, T.P., *Access to the Local Loop, Kennedy School of Government, Harvard University, Infrastructures in Massachusetts*, March, 1993.

1993 [2], McGarty, T.P., *Wireless Access to the Local Loop, MIT Universal Personal Communications Symposium*, March, 1993. FCC Ex Parte, February 4, 1993.

1993, [3], McGarty, T.P., *Spectrum Allocation Alternatives; Industrial; Policy versus Fiscal Policy, MIT Universal Personal Communications Symposium*, March, 1993. FCC Ex Parte, February 4, 1993.

1993 [4], McGarty, T.P., *Access Policy and the Changing Telecommunications Infrastructures, Telecommunications Policy Research Conference*, Solomon's Island, MD, September, 1993. FCC Ex Parte, August 15, 1993.

1994 [1], McGarty, T.P., *A Précis on PCS Economics and Access Fees, MIT Conference on Access, MIT Lincoln Laboratory*, March 18, 1994. FCC Ex Parte, May 30, 1994.

### **CERTIFICATE OF SERVICE**

**I, Terrence P. McGarty, hereby certify that a copy of the foregoing has been sent by United States Postal Service Express Mail with Next Day Delivery (\*) or by United States mail, first class and postage prepaid, to the following on this day, May 30, 1994:**

**The Honorable Reed E. Hundt (\*)**  
Chairman,  
Federal Communications Commission  
1919 M Street, N.W., Room 832  
Washington, D.C. 20554

**The Honorable Anne K. Bingaman (\*)**  
Assistant Attorney General, Antitrust  
Department  
Department of Justice  
Tenth Street and Constitution Ave, NW  
Washington, DC 20530

**The Honorable James H. Quello (\*)**  
Commissioner,  
Federal Communications Commission  
1919 M Street, N.W., Room 802  
Washington, D.C. 20554

**The Honorable Andrew C. Barrett (\*)**  
Commissioner,  
Federal Communications Commission  
1919 M Street, N.W., Room 844  
Washington, D.C. 20554

**The Honorable Rachelle B. Chong (\*)**  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

**The Honorable Susan Ness (\*)**  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

**Dr. Robert M. Pepper, Chief (\*)**  
Office of Plans and Policy  
Federal Communications Commission  
1919 M Street, Room 822  
Washington, D.C. 20554

**Dr. Thomas P. Stanley, Chief (\*)**  
Office of Engineering and Technology  
Federal Communications Commission  
2025 M Street, Room 7002

Washington, D.C., 20554

**Gail Brown (\*)**  
Private Radio Bureau, Room 5002  
Federal Communications Commission  
2025 M Street, Room 7002  
Washington, D.C., 20554

**Donald Gips, Deputy Chief (\*)**  
Office of Plans and Policy  
Federal Communications Commission  
1919 M Street, Room 822  
Washington, D.C. 20554

**Ameritech**  
Robert N. Reiland  
30 South Wacker Drive  
Suite 3900  
Chicago, IL 60606

**Bellsouth Corporation**  
William B. Barfield  
1155 Peachtree St. NE  
Atlanta, GA 30367

**Bell Atlantic**  
James H. Barker  
Latham & Watkins  
1001 Pennsylvania Ave  
Suite 1300  
Washington, DC 20004

**GTE Service Corporation**  
Gail L. Polivy  
1850 M Street NW  
Washington, DC 20036

**NYNEX Corporation**  
Mirijana Kocho  
120 Bloomingdale Rd  
White Plains, NY 10605

**Pacific Bell**  
Michael K. Kellogg  
Kellogg, Huber & Hansen

1301 K Street, NW  
Washington, DC 20005

Southwestern Bell  
Paula Fulks  
175 E Houston, Room 1218  
San Antonio, TX 78025

US West  
Jeffrey S. Bork  
1020 19th Street, NW Suite 700  
Washington, DC 20036

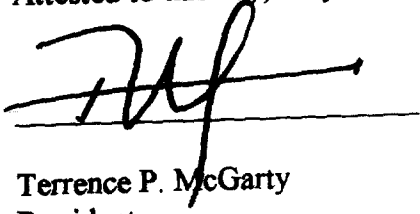
Ted Schell  
Senior Vice President  
Sprint  
2330 Shawnee Mission Parkway  
Westwood, KS 66205

Richard Liebhaber  
Executive Vice President  
MCI  
1801 Pennsylvania Ave.  
Washington, DC 20006

Richard Bodman  
Senior Vice President  
AT&T  
295 N. Maple Ave  
Basking Ridge, NJ 07920

Kenneth Gordon  
Chairman  
Massachusetts Department of Public  
Utilities  
100 Cambridge St.  
Boston, MA 02202

Attested to this day, May 30, 1994,

A handwritten signature in black ink, appearing to be 'T. McGarty', is written over a horizontal line.

Terrence P. McGarty  
President,  
National PCS Consortium, Inc.